



Annual Report

SEPTEMBER 30, 2005

Waddell & Reed Advisors Municipal High Income Fund



WADDELL
& REED
Advisors Funds

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This report is submitted for the general information of the shareholders of Waddell & Reed Advisors Municipal High Income Fund, Inc. It is not authorized for distribution to prospective investors in the Fund unless preceded or accompanied by a current Waddell & Reed Advisors Municipal High Income Fund, Inc. prospectus and current Fund performance information.

President's Letter

September 30, 2005



DEAR SHAREHOLDER:

Enclosed is our report on your Fund's operations for the 12 months ended September 30, 2005. The 12-month period brought quite positive results for most investors, despite challenges from a variety of directions in the latter half of the period. Stocks ended the fiscal year higher, as the S&P 500 returned 12.25 percent, and the Dow Jones Industrial Average rose 7.22 percent. Bonds also rose slightly, with the Citigroup Broad Investment Grade Index returning 2.93 percent over the last 12 months.

The first half of the 12-month period brought strong economic growth, solid corporate earnings and a generally positive environment for investors. The last six months brought a few challenges, although the financial markets have remained fairly resilient. Between April and September, we weathered increasing energy prices, rising interest rates, budding inflationary pressures and, most dramatically, the fallout from two major hurricanes that tragically struck this country's Gulf Coast. Hurricane Katrina silenced an entire major American city, along with the largest port facility in the country, which is the fifth largest port in the world. Compounded by Hurricane Rita several weeks later, it brought devastating circumstances across four states and an economic impact that is still being evaluated.

Despite the setbacks, the U.S. economy has remained relatively solid. As we look toward 2006, it does appear that economic growth will slow somewhat in the U.S., in our opinion, due to higher interest rates and higher energy prices.

The Federal Reserve apparently believes the economy is sound enough that it has continued its campaign of steadily raising short-term interest rates. Most recently, the Fed enacted another quarter-point increase in late September, bringing interest rates to 3.75 percent. The Fed stated that it still believes monetary conditions remain "accommodative," indicating apparently that they intend to continue raising rates somewhat further.

The other major development during the period was the rapid rise of oil prices. Crude oil hovered just above \$40 per barrel in late 2004. By the end of September 2005, the price surpassed \$65 per barrel. The world is facing constraints in supply such as we have never seen before. Many are forecasting that prices may ease some toward year-end, but we believe that, longer term, higher prices are here to stay. As investors, we must remain aware of that reality, its impact on the world economies, and any opportunities that it may create.

Regardless of the short-term challenges brought on by economic or geopolitical events, a longer-term perspective is often more instructive for investors. That is why we believe it is important to develop and maintain a long-term financial plan for your personal situation. Through appropriate diversification among four or five or so different asset classes, you can potentially provide more balance to your investment portfolio over time.

Respectfully,

A handwritten signature in black ink, reading "Henry J. Herrmann". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Henry J. Herrmann, CFA
President

Your financial advisor can help you with these strategies and work with you to develop and maintain a customized plan based on your individual situation. We believe that focusing on that plan, despite the swings of the market, is important as you work toward a sound financial future.

Thank you for your partnership and your continued commitment to your investment program.

The opinions expressed in this letter are those of the President of the Fund and are current only through the end of the period of the report, as stated on the cover. The President's views are subject to change at any time, based on market and other conditions, and no forecasts can be guaranteed.

Manager's Discussion of Municipal High Income Fund

September 30, 2005



An interview with Mark J. Otterstrom, CFA, portfolio manager of Waddell & Reed Advisors Municipal High Income Fund, Inc.

The following discussion, graphs and tables provide you with information regarding the Fund's performance for the fiscal year ended September 30, 2005.

How did the Fund perform during the last fiscal year?

The Fund's Class A shares increased 7.45 percent for the fiscal year (before the impact of any sales charges), compared with the Lehman Brothers Municipal Bond Index (reflecting the performance of securities that generally represent the municipal bond market), which increased 4.08 percent for the period, and the Lipper High Yield Municipal Debt Funds Universe Average (reflecting the performance of funds with similar investment objectives), which increased 7.26 percent for the period. Please note that the Fund returns include applicable fees and expenses, whereas the index returns do not include any such fees.

What factors impacted Fund performance during the fiscal year?

We believe the major factors that contributed to Fund performance over the last 12 months have been our credit selection, sector selection and duration management. The Fund had numerous holdings upgraded, some at times going from non-rated to investment grade. When a municipal bond is pre-refunded, it is converted from a long duration, lower-credit-quality bond into a short duration, high-credit-quality bond. It benefits from rolling down the yield curve at the same time that it rolls up the credit curve.

Several of our larger holdings were pre-refunded, causing these bonds to experience a substantial price appreciation. We increased our exposure to tobacco bonds, which was by far the strongest performing sector in the municipal high yield universe over the fiscal year. The health care sector, where we had the largest exposure, saw substantial credit spread tightening over the last 12 months. Through our credit selection process, we were able to minimize negative credit events and enhance total return while improving the credit quality of the Fund.

What other market conditions or events influenced the Fund's performance during the fiscal year?

The Federal Reserve has steadily tightened monetary policy throughout the year. The Fed has successfully increased short-term interest rates without cutting off economic activity. Influenced by the Fed tightening, the municipal bond market has experienced a substantial yield curve flattening. What has surprised most market participants is the low level of interest rates at the long end of the curve. One-year, tax-free rates increased more than 125 basis points, while 20-year rates fell 10 basis points. Due to the persistently low rates at the long end of the curve, municipal bond buyers have continued to reach for yield by increasing their exposure to low and medium investment grade bonds. As a result,

credit spreads have contracted substantially over the last 12 months. Tight credit spreads and low absolute yields allowed a substantial amount of our holdings to be pre-refunded.

What strategies and techniques did you employ that specifically affected the Fund's performance?

In addition to increasing the Fund's exposure in sectors that experienced substantial credit spread tightening, we attempted to manage our overall duration using a barbell approach. We chose to own short-duration, high quality bonds in an effort to shorten overall portfolio duration and provide liquidity to the Fund. At the same time, we were able to lower our cash position and stay more fully invested. The bulk of the portfolio was held in longer duration, higher yielding bonds, which performed well. If we had shortened duration by selling our long-duration bonds and buying securities in the intermediate part of the curve, we likely would not have benefited from the yield curve flattening and credit spread tightening that occurred over the last 12 months. We also made a conscious decision not to chase yield. We held onto our higher yielding bonds with good credit characteristics and did not buy new issues containing deteriorating credit standards.

What industries or sectors did you emphasize during the fiscal year, and what is your outlook for the next 12 months?

Health care continues as one of our higher allocations. We feel that the not-for-profit

hospital sector gives the Fund opportunities to broadly diversify across cities, states and regions of the country. We therefore can diversify between urban and suburban facilities, as well as sole community providers. As the United States population ages, there is a growing demand for senior housing. Part of this demand has been filled with the growth in not-for-profit continuing care retirement centers. We have found this sector of the high yield municipal bond market to be a reliable source of new supply. This has been a very successful sector with a very good track record of financial improvement. Special tax districts and non-rated, limited-tax general obligation bonds also have been a healthy source of new bond issues. Throughout the year, we were able to diversify out of health care and into a broader range of sectors, including water/sewer, transportation and industrial development bonds.

Due to the huge demand for high yield municipal bonds, we believe that credit spreads could remain relatively narrow for the foreseeable future. We anticipate looking to industrial revenue, special tax district and transportation sectors to add value. We also feel that the health care sector continues to offer some opportunities for price appreciation and relatively high income. We intend to continue to keep the Fund fully invested and duration-neutral to its peer group. Overall, we continue to feel that it is important that we stay broadly diversified across municipal bond sectors and geographic regions.

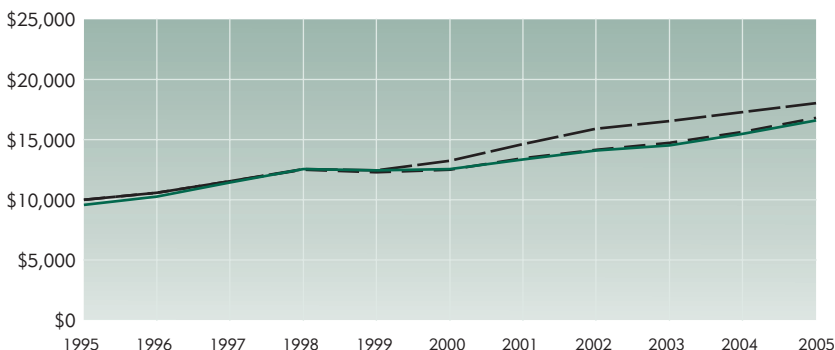
The Fund's performance noted above is at net asset value (NAV), and does not include the effect of any applicable sales charges. If reflected, the sales charge would reduce the performance noted.

As with any mutual fund, the value of the Fund's shares will change, and you could lose money on your investment. Investing in high-income securities may carry a greater risk of nonpayment of interest or principal than higher-rated bonds. Fixed-income securities are subject to interest-rate risk and, as such, the net asset value of the Fund may fall as interest rates rise. These and other risks are more fully described in the Fund's prospectus.

The opinions expressed in this report are those of the portfolio manager and are current only through the end of the period of the report as stated on the cover. The manager's views are subject to change at any time based on market and other conditions, and no forecasts can be guaranteed.

Comparison of Change in Value of \$10,000 Investment

—	Waddell & Reed Advisors Municipal High Income Fund, Inc., Class A Shares ⁽¹⁾	\$16,637
— — —	Lehman Brothers Municipal Bond Index	\$18,025
— — —	Lipper High Yield Municipal Debt Funds Universe Average	\$16,803



Please note that the performance of the Fund's other share classes will be greater or less than the performance shown above for Class A based on the differences in loads and fees paid by shareholders investing in the different classes.

(1) The value of the investment in the Fund is impacted by the sales load at the time of the investment and by the ongoing expenses of the Fund and assumes reinvestment of dividends and distributions.

Average Annual Total Return⁽²⁾

	Class A	Class B	Class C	Class Y
1-year period ended 9-30-05	2.88%	2.53%	6.49%	7.67%
5-year period ended 9-30-05	4.89%	4.75%	4.91%	5.89%
10-year period ended 9-30-05	5.22%	—	—	—
Since inception of Class ⁽³⁾ through 9-30-05	—	4.00%	4.13%	4.17%

(2) Data quoted is past performance and is based on deduction of the maximum applicable sales load for each of the periods. Current performance may be lower or higher. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate and shares, when redeemed, may be worth more or less than their original cost. Please visit www.waddell.com for the Fund's most recent month-end performance. Class A shares carry a maximum front-end sales load of 4.25%. Class B and Class C shares carry maximum contingent deferred sales charges (CDSC) of 5% and 1%, respectively. (Accordingly, the Class C shares reflect no CDSC since it only applies to Class A shares redeemed within twelve months after purchase.) Class Y shares are not subject to sales charges.

(3) 10-5-99 for Class B shares, 10-8-99 for Class C shares and 12-30-98 for Class Y shares (the date on which shares were first acquired and continuously held by shareholders).

Past performance is not necessarily indicative of future performance. Indexes are unmanaged. The performance graph and table do not reflect the deduction of taxes that a shareholder would pay on Fund distributions or on the redemption of Fund shares.

Illustration of Fund Expenses

MUNICIPAL HIGH INCOME FUND

As a shareholder of the Fund, you incur two types of costs: (1) transaction costs, including sales charges (loads) on purchase payments, redemption fees and exchange fees; and (2) ongoing costs, including management fees, distribution and service fees, and other Fund expenses. The following table is intended to help you understand your ongoing costs (in dollars) of investing in the Fund and to compare these costs with the ongoing costs of investing in other mutual funds. The example is based on an investment of \$1,000 invested at the beginning of the period and held for the six-month period ended September 30, 2005.

Actual Expenses

The first line for each share class in the following table provides information about actual account values and actual expenses. You may use the information in this line, together with the amount you invested, to estimate the expenses that you paid over the period. Simply divide your account value by \$1,000 (for example, a \$7,500 account value divided by \$1,000 = 7.5), then multiply the result by the number in the first line under the heading entitled "Expenses Paid During Period" to estimate the expenses you paid on your account during this period. There may be additional fees charged to holders of certain accounts that are not included in the expenses shown in the table. These fees apply to Individual Retirement Accounts (IRAs), IRA Rollovers, Roth IRAs, Conversion Roth IRAs, Simplified Employee Pension (SEP), Simple IRAs, Tax-Sheltered Accounts (TSAs), Keogh Plans, Owner Only 401(k) (Exclusive K) Plans and Final Pay Plans. As of the close of the six months covered by the table, a customer is charged an annual fee of \$15 within each plan type. This fee is waived for IRA Rollovers and Conversion Roth IRAs if the customer owns another type of IRA. Coverdell Education Savings Account plans are charged an annual fee of \$10 per customer. You should consider the additional fees that were charged to your Fund account over the six-month period when you estimate the total ongoing expenses paid over the period and the impact of these fees on your ending account value as such additional expenses are not reflected in the information provided in the expense table. Additional fees have the effect of reducing investment returns.

Hypothetical Example for Comparison Purposes

The second line for each share class of the following table provides information about hypothetical account values and hypothetical expenses based on the Fund's actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Fund's actual return. The hypothetical account values and expenses may not be used to estimate the actual ending account balance or expenses you paid for the period. You may use this information to compare the ongoing costs of investing in the Fund and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds. Please note that the expenses shown in the table are meant to highlight your ongoing costs only and do not reflect any transactional costs, such as sales charges (loads), redemption fees or exchange fees. Therefore, the second line of each share class in the table is useful in comparing ongoing costs only, and will not help you determine the relative total costs of owning different funds. In addition, if these transactional costs were included, your costs would have been higher.

Fund Expenses

For the Six Months Ended September 30, 2005	Beginning Account Value 3-31-05	Ending Account Value 9-30-05	Annualized Expense Ratio Based on the Six-Month Period	Expenses Paid During Period*
Based on Actual Fund Return⁽¹⁾				
Class A	\$1,000	\$1,035.80	0.96 %	\$4.88
Class B	1,000	1,031.30	1.82	9.26
Class C	1,000	1,031.10	1.85	9.44
Class Y	1,000	1,036.80	0.76	3.88
Based on 5% Return⁽²⁾				
Class A	\$1,000	\$1,020.28	0.96 %	\$4.84
Class B	1,000	1,015.95	1.82	9.19
Class C	1,000	1,015.77	1.85	9.37
Class Y	1,000	1,021.26	0.76	3.85

*Fund expenses for each share class are equal to the Fund's annualized expense ratio for each share class (provided in the table), multiplied by the average account value over the period, multiplied by 183 days in the six-month period ended September 30, 2005, and divided by 365.

(1) This section uses the Fund's actual total return and actual Fund expenses. It is a guide to the actual expenses paid by the Fund in the period. The "Ending Account Value" shown is computed using the Fund's actual return and the "Expenses Paid During Period" column shows the dollar amount that would have been paid by an investor who started with \$1,000 in the Fund. A shareholder may use the information here, together with the dollar amount invested, to estimate the expenses that were paid over the period. For every thousand dollars a shareholder has invested, the expenses are listed in the fourth column.

(2) This section uses a hypothetical 5% return and actual Fund expenses. It helps to compare the Fund's ongoing costs with other mutual funds. A shareholder can compare the Fund's ongoing costs by comparing this hypothetical example with the hypothetical examples that appear in shareholder reports of other funds.

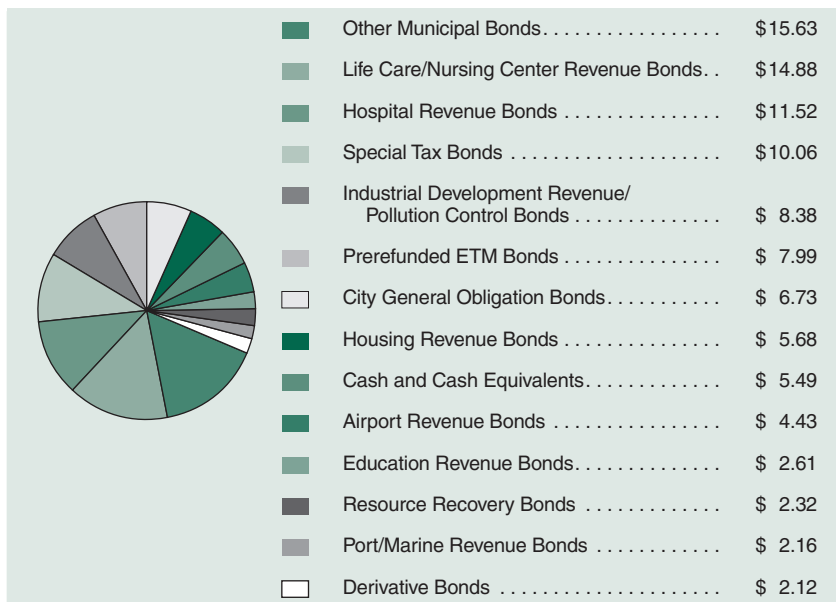
The above illustration is based on ongoing costs only and does not include any transactional costs, such as sales loads, redemption fees or exchange fees.

SHAREHOLDER SUMMARY OF MUNICIPAL HIGH INCOME FUND

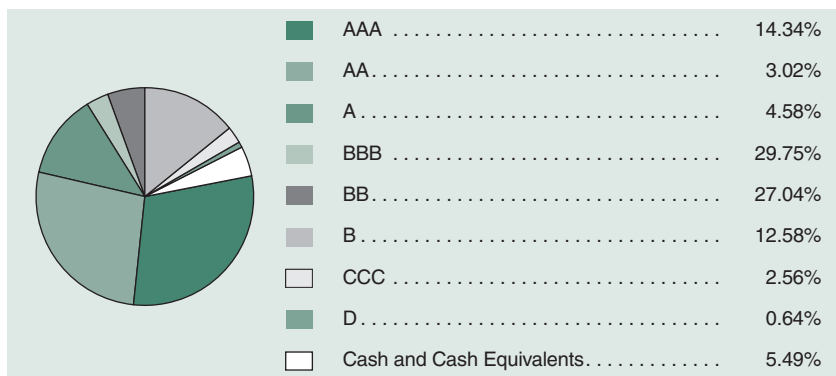
Portfolio Highlights

On September 30, 2005, Waddell & Reed Advisors Municipal High Income Fund, Inc. had net assets totaling \$422,525,066 invested in a diversified portfolio.

As a shareholder of the Fund, for every \$100 you had invested on September 30, 2005, your Fund owned:



On September 30, 2005, the breakdown of bonds (by ratings) held by the Fund was as follows:



Ratings reflected in the wheel above are taken from the following sources in order of preference: Standard & Poor's, Moody's or, if unrated, judged by WRIMCO to be of equivalent quality.

2005 Tax Year Taxable Equivalent Yields⁽¹⁾

If your Taxable Income is:		Your Marginal Tax Bracket Is	Equivalent Tax Free Yields			
Joint Return	Single Return		3%	4%	5%	6%
\$ 0 - 14,600	\$ 0 - 7,300	10%	3.33%	4.44%	5.56%	6.67%
\$ 14,601 - 59,400	\$ 7,301 - 29,700	15%	3.53%	4.71%	5.88%	7.06%
\$ 59,401 - 119,950	\$ 29,701 - 71,950	25%	4.00%	5.33%	6.67%	8.00%
\$ 119,951 - 182,800	\$ 71,951 - 150,150	28%	4.17%	5.56%	6.94%	8.33%
\$ 182,801 - 326,450	\$ 150,151 - 326,450	33%	4.48%	5.97%	7.46%	8.96%
\$326,451 and above	\$326,451 and above	35%	4.62%	6.15%	7.69%	9.23%

(1) Table is for illustration only and does not represent the actual performance of Waddell & Reed Advisors Municipal High Income Fund, Inc.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS	Principal Amount in Thousands	Value
Arizona – 2.91%		
Arizona Health Facilities Authority, Hospital Revenue Bonds (John C. Lincoln Health Network), Series 2000, 7.0%, 12–1–25	\$3,500	\$ 3,899,105
Hayden-Winkelman Unified School District No. 41 of Gila County, Arizona, Capital Appreciation Refunding Bonds, Series 1995, 0.0%, 7–1–10	4,925	3,773,436
The Industrial Development Authority of the County of Pima, Education Revenue Bonds: Paradise Education Center Project, Series 2003A, 5.75%, 6–1–24	2,100	2,078,517
Noah Webster Basic School Project, Series 2004A, 6.125%, 12–15–34	1,115	1,122,270
The Industrial Development Authority of the City of Tucson, Arizona, Education Revenue Bonds (Arizona Agribusiness and Equine Center, Inc. Project), Series 2004A, 6.125%, 9–1–34	1,380	1,413,658
		<u>12,286,986</u>
California – 2.48%		
Golden State Tobacco Securitization Corporation, Tobacco Settlement Asset-Backed Bonds, Series 2003A–1 (Fixed Rate), 6.75%, 6–1–39	5,000	5,749,300
State of California Various Purpose General Obligation Bonds, 5.0%, 2–1–23	2,620	2,739,551
California Statewide Communities Development Authority, Multifamily Housing Revenue Bonds (Colton Gardens Apartments Project), Series 2003A, 6.25%, 7–1–42	2,000	1,998,460
		<u>10,487,311</u>

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Colorado – 11.91%		
City and County of Denver, Colorado, Airport System Revenue Refunding Bonds, Series 2002E:		
5.25%, 11–15–13	\$6,000	\$ 6,402,540
5.25%, 11–15–14	4,000	4,253,160
Colorado Educational and Cultural Facilities Authority, Charter School Revenue Bonds:		
Collegiate Academy of Colorado Project, A Charter School Created by Jefferson County School District R–1, Jefferson County, State of Colorado, Series 2002:		
7.5%, 12–15–31	3,000	3,490,860
7.375%, 12–15–21	1,000	1,158,760
Stargate Charter School Project, Series 2002:		
6.0%, 5–1–22	1,605	1,616,556
6.125%, 5–1–33	1,000	1,010,490
Sand Creek Metropolitan District, Adams County and City and County of Denver, Colorado, General Obligation Limited Tax Bonds:		
Series 1998,		
6.625%, 12–1–17	2,695	2,931,944
Series 1997,		
7.125%, 12–1–16	1,840	1,995,885
Rampart Range Metropolitan District No. 1 (in the City of Lone Tree, Colorado), Revenue Bonds (Rampart Range Metropolitan District No. 2 Project), Series 2001,		
7.75%, 12–1–26	4,475	4,677,136
Aspen Grove Business Improvement District in the City of Littleton, Colorado, Limited Tax General Obligation Bonds, Series 2001,		
7.625%, 12–1–25	3,637	3,779,061
Pine Bluffs Metropolitan District (in the Town of Parker), Douglas County, Colorado, General Obligation Limited Tax Bonds, Series 2004,		
7.25%, 12–1–24	3,325	3,389,040

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Colorado (Continued)		
Southlands Metropolitan District No. 1 (in the City of Aurora), Arapahoe County, Colorado, General Obligation Bonds (Limited Tax Convertible to Unlimited Tax), Series 2004, 7.125%, 12-1-34	\$2,000	\$ 2,196,720
Wyndham Hill Metropolitan District No. 2, Town of Frederick, Colorado, General Obligation Limited Tax Bonds, Series 2005:		
6.375%, 12-1-35	1,000	999,890
6.25%, 12-1-25	750	749,925
Cordillera Mountain Metropolitan District (Eagle County, Colorado), Subordinate Limited Tax (Convertible to Party Unlimited Tax), General Obligation Bonds, Series 2000B,		
6.2%, 12-1-20	1,450	1,564,550
Castle Oaks Metropolitan District in the Town of Castle Rock, Douglas County, Colorado, General Obligation Limited Tax Bonds, Series 2005:		
6.125%, 12-1-35	1,000	998,400
6.0%, 12-1-25	500	499,950
Red Sky Ranch Metropolitan District, Eagle County, Colorado, General Obligation Bonds, Series 2003,		
6.05%, 12-1-33	1,245	1,297,713
Church Ranch Metropolitan District, City of Westminster, Colorado, General Obligation Limited Tax Bonds, Series 2003,		
6.0%, 12-1-33	1,260	1,279,379
Piney Creek Village Metropolitan District, Arapahoe County, Colorado, General Obligation Bonds (Limited Tax Convertible to Unlimited Tax), Series 2005,		
5.5%, 12-1-35	1,100	1,105,016
Tallyn's Reach Metropolitan District No. 3 (in the City of Aurora, Colorado), Limited Tax (Convertible to Unlimited Tax), General Obligation Bonds, Series 2004,		
6.75%, 12-1-33	1,000	1,021,220

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Colorado (Continued)		
Beacon Point Metropolitan District (in the City of Aurora, Colorado), Limited Tax (Convertible to Unlimited Tax), General Obligation Bonds, Series 2005A, 6.125%, 12-1-25	\$1,000	\$ 1,007,790
High Plains Metropolitan District (in the City of Aurora, Colorado), Limited Tax (Convertible to Unlimited Tax), General Obligation Bonds, Series 2005A, 6.125%, 12-1-25	1,000	1,007,790
Wheatlands Metropolitan District No. 2 (in the City of Aurora, Colorado), General Obligation Bonds (Limited Tax Convertible to Unlimited Tax), Series 2005, 6.125%, 12-1-35	1,000	999,220
Deer Creek Metropolitan District, Jefferson County, Colorado, General Obligation Bonds, Series 2000, 7.625%, 12-1-19	750	908,520
		<u>50,341,515</u>
Connecticut – 2.25%		
Eastern Connecticut Resource Recovery Authority, Solid Waste Revenue Bonds (Wheelabrator Lisbon Project), Series 1993A, 5.5%, 1-1-14	5,250	5,279,347
Connecticut Development Authority, Pollution Control Revenue Refunding Bonds (The Connecticut Light and Power Company Project – 1993B Series), 5.95%, 9-1-28	2,500	2,646,975
State of Connecticut Health and Educational Facilities Authority, Revenue Bonds, Hospital for Special Care Issue, Series B, 5.375%, 7-1-17	1,580	1,571,026
		<u>9,497,348</u>
Florida – 2.57%		
Capital Projects Finance Authority, Continuing Care Retirement Community, Revenue Bonds (Capital Projects Loan Program – The Glenridge on Palmer Ranch Project), Fixed Rate Revenue Bonds, Series 2002A, 8.0%, 6-1-32	5,000	5,585,600
State of Florida, Full Faith and Credit, State Board of Education, Public Education Capital Outlay Bonds, 2000 Series A, 5.125%, 6-1-19	4,930	5,291,122
		<u>10,876,722</u>

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Georgia – 1.24%		
Brunswick and Glynn County Development Authority, Fixed Rate First Mortgage Revenue Bonds (Coastal Community Retirement Corporation – Marsh's Edge Project), Series 2004A, 7.25%, 1–1–35	\$2,800	\$ 2,956,492
Savannah Economic Development Authority, First Mortgage Revenue Bonds (The Marshes of Skidaway Island Project), Series 2003A: 7.4%, 1–1–34	1,650	1,748,142
7.4%, 1–1–24	510	545,828
		<u>5,250,462</u>
Illinois – 2.41%		
Bloomington-Normal Airport Authority of McLean County, Illinois, Central Illinois Regional Airport, Passenger Facility Charge Revenue Bonds, Series 2001: 6.35%, 12–15–24	2,975	3,023,106
6.05%, 12–15–19	1,000	1,007,580
Village of Maywood, General Obligation Corporate Purpose Bonds, Series 2001C (Tax-Exempt), 5.5%, 1–1–21	2,000	2,205,940
Illinois Health Facilities Authority Series 2003A–1 (Villa St. Benedict Project), 6.9%, 11–15–33	2,000	2,154,100
Village of Hodgkins, Cook County, Illinois, Tax Increment Revenue Refunding Bonds, Series 1995A, 7.625%, 12–1–13	1,750	1,798,807
		<u>10,189,533</u>
Iowa – 1.58%		
City of Cedar Rapids, Iowa: First Mortgage Revenue Bonds, Series 1998-A (Cottage Grove Place Project), 5.875%, 7–1–28	5,000	4,022,350
First Mortgage Adjustable Revenue Bonds, Series 2004 (Cottage Grove Place Project), 6.5%, 7–1–33	2,655	2,654,841
		<u>6,677,191</u>

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Kansas – 1.33%		
City of Olathe, Kansas, Senior Living Facility Revenue Bonds (Aberdeen Village, Inc.), Series 2000A, 8.0%, 5–15–30	\$3,255	\$ 3,915,081
Certificates of Participation, Series 1998A, Evidencing Proportionate Interests of the Owners Thereof in Rental Payments to be Made by the City of Spring Hill, Kansas, to Spring Hill Golf Corporation:		
6.5%, 1–15–28 (A)	4,145	1,659,161
6.375%, 1–15–20 (A)	60	24,029
5.75%, 1–15–06 (A)	50	20,000
		<u>5,618,271</u>
Louisiana – 0.91%		
Louisiana Local Government Environmental Facilities and Community Development Authority, Multifamily Housing Revenue Bond Anticipation Notes (Kingston Point and Camelot Apartments Project), Series 2001A, 6.25%, 1–1–06	4,000	<u>3,861,440</u>
Maine – 1.60%		
Maine Health and Higher Educational Facilities Authority, Revenue Bonds, Piper Shores Issue, Series 1999A:		
7.55%, 1–1–29	5,000	5,660,500
7.5%, 1–1–19	1,000	1,107,300
		<u>6,767,800</u>
Maryland – 0.36%		
Maryland Economic Development Corporation, Senior Lien Revenue Bonds (Rocky Gap Golf Course and Hotel/Meeting Center Project), Series 1996 A, 8.375%, 10–1–09 (A)	3,250	<u>1,527,500</u>
Massachusetts – 2.60%		
Massachusetts Industrial Finance Agency:		
First Mortgage Revenue Bonds, Reeds Landing Project, Series 1993, 7.1%, 10–1–28	7,400	7,414,060
Resource Recovery Revenue Refunding Bonds (Ogden Haverhill Project), Series 1998A Bonds:		
5.6%, 12–1–19	2,500	2,536,850
5.5%, 12–1–13	1,000	1,018,770
		<u>10,969,680</u>

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Michigan – 0.66%		
Garden City Hospital Finance Authority, Hospital Revenue and Refunding Bonds (Garden City Hospital Obligated Group), Series 1998A, 5.75%, 9–1–17	\$2,820	<u>\$ 2,774,542</u>
Missouri – 14.57%		
Missouri Development Finance Board, Infrastructure Facilities Revenue Bonds: City of St. Joseph, Missouri: Sewerage System Improvements Project, Series 2004C, 5.0%, 3–1–25	3,500	3,602,375
Triumph Foods, LLC Project, Series 2004A: 6.0%, 3–1–15	1,000	1,072,280
5.25%, 3–1–25	500	518,395
City of Branson, Missouri (Branson Landing Project): Series 2004A: 5.5%, 12–1–24	2,000	2,106,760
5.625%, 12–1–28	1,000	1,057,800
Series 2005A, 6.0%, 6–1–20	1,000	1,156,120
City of Independence, Missouri, Eastland Center Project: Phase II, Series 2002B, 6.0%, 4–1–21	2,100	2,237,613
Phase IV, Series 2000B, 5.125%, 4–1–22	875	922,583
Santa Fe Redevelopment Project, Series 2001, 5.25%, 4–1–23	2,500	2,640,025
The Industrial Development Authority of the City of Kansas City, Missouri: Health Care Facilities First Mortgage Revenue Bonds (The Bishop Spencer Place, Incorporated Project), Series 1994: 6.5%, 1–1–35	1,500	1,557,810
6.25%, 1–1–24	1,000	1,032,450
Revenue Bonds, Series 2004 (Plaza Library Project), 5.9%, 3–1–24	2,500	2,551,275
Multifamily Housing Revenue Bonds (Village Green Apartments Project), Series 1998, 6.25%, 4–1–30	3,280	2,291,539

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Missouri (Continued)		
The Industrial Development Authority of St. Joseph, Missouri:		
Healthcare Revenue Bonds (Living Community of St. Joseph Project), Series 2002, 7.0%, 8-15-32	\$3,000	\$ 3,217,200
Tax Increment Revenue Bonds, Series 2005B (The Shoppes at North Village Project):		
5.5%, 11-1-27	1,000	994,890
5.375%, 11-1-23	1,000	991,860
City of Des Peres, Missouri, Tax Increment Refunding Revenue Bonds, Series 2002A (West County Center Project),		
5.75%, 4-15-20	4,000	4,106,800
City of Belton, Missouri, Tax Increment Revenue Bonds (Belton Town Centre Project), Series 2004:		
6.0%, 3-1-19	2,610	2,656,327
6.25%, 3-1-24	1,000	1,017,570
Missouri Housing Development Commission, Multifamily Housing Revenue Bonds (The Mansion Apartments Phase II Project), Series 1999,		
6.17%, 4-1-32	3,915	3,645,609
The Industrial Development Authority of the City of Cameron, Missouri, Health Facilities Revenue Bonds (Cameron Community Hospital), Series 2000,		
6.25%, 12-1-21	3,250	3,533,140
M150 and 135th Street Transportation Development District Transportation Sales Tax Revenue Bonds (State Line Station Project-Kansas City, Missouri), Series 2004,		
6.0%, 10-1-34	2,700	2,792,880
City of Lake Ozark, Missouri, Neighborhood Improvement District Bonds (Osage National Project), Series 2005:		
6.1%, 3-1-25	1,390	1,421,831
5.6%, 3-1-17	685	695,467
5.6%, 3-1-11	425	427,333
City of Ballwin, Missouri, Tax Increment Refunding and Improvement Revenue Bonds, Series 2002A (Ballwin Town Center Redevelopment Project),		
6.25%, 10-1-17	2,200	2,245,188

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Missouri (Continued)		
The City of Nevada, Missouri (Nevada Regional Medical Center), Hospital Revenue Bonds, Series 2001, 6.75%, 10-1-22	\$2,000	\$ 2,090,380
City of Chesterfield, Missouri, Tax Increment Refunding and Improvement Revenue Bonds, Series 2002 (Chesterfield Valley Projects), 4.5%, 4-15-16	2,065	2,072,145
City of Riverside, Missouri, L-385 Levee Redevelopment Plan, Tax Increment Revenue Bonds (L-385 Levee Project), Series 2004, 5.25%, 5-1-20	2,000	2,049,820
City of Liberty, Missouri, Tax Increment Revenue Bonds, (Liberty Triangle Project), Series 2004:		
5.375%, 9-1-19	1,000	1,006,660
5.75%, 9-1-24	750	752,790
5.875%, 9-1-26	250	252,105
City of Maplewood, Missouri, Tax Increment Refunding Revenue Bonds, Series 2005 (Maplewood South Redevelopment Area Project), 5.75%, 11-1-26	1,700	1,683,340
The St. Charles Riverfront Transportation Development District, St. Charles, Missouri, Revenue Bonds (River Bluff Drive Improvement Project), Series 2005:		
5.0%, 10-1-20	800	789,208
5.25%, 4-1-25	400	383,180
		61,572,748
Nevada – 0.85%		
Clark County, Nevada, Special Improvement District No. 142 (Mountain's Edge), Local Improvement Bonds, Series 2003:		
5.8%, 8-1-15	2,000	2,062,020
6.375%, 8-1-23	1,500	1,543,545
		3,605,565
New Hampshire – 1.27%		
New Hampshire Health and Education Facilities Authority, Hospital Revenue Bonds, Catholic Medical Center Issue, Series 2002A:		
5.75%, 7-1-22	2,000	2,074,680
5.0%, 7-1-12	625	645,519

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
New Hampshire (Continued)		
Business Finance Authority of the State of New Hampshire, Revenue Bonds (Franklin Regional Hospital Association Project), Series A, 6.05%, 9-1-29	\$1,945	\$ 1,925,472
Lisbon Regional School District, New Hampshire, General Obligation Capital Appreciation School Bonds, 0.0%, 2-1-13	845	722,331
		<u>5,368,002</u>
New Jersey – 5.01%		
New Jersey Economic Development Authority:		
Economic Development Bonds, Kapkowski Road Landfill Reclamation Improvement District Project (City of Elizabeth), Series 1998A (Non-AMT):		
5.5%, 4-1-12	5,955	6,279,964
6.375%, 4-1-18	2,385	2,841,990
First Mortgage Revenue Fixed Rate Refunding Bonds (Winchester Gardens at Ward Homestead Project), Series 1996A,		
8.625%, 11-1-25	3,000	3,238,440
Fixed Rate First Mortgage Revenue Bonds (Lions Gate Project), Series 2005A:		
5.875%, 1-1-37	1,230	1,254,637
5.75%, 1-1-25	710	727,821
Tobacco Settlement Financing Corporation, Tobacco Settlement Asset-Backed Bonds, Series 2003,		
6.75%, 6-1-39	5,000	5,819,900
Camden County Improvement Authority, Health Care Redevelopment Project Revenue Bonds, The Cooper Health System Obligated Group Issue, Series 1997,		
6.0%, 2-15-27	1,000	1,020,600
		<u>21,183,352</u>

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
New York – 7.88%		
Suffolk County Industrial Development Agency (New York):		
Civic Facility Revenue Bonds, The Southampton		
Hospital Association Civic Facility:		
Series 1999B,		
7.625%, 1–1–30	\$4,900	\$ 5,122,215
Series 1999A,		
7.25%, 1–1–20	2,000	2,054,020
Continuing Care Retirement Community:		
Fixed Rate Revenue Bonds (Peconic Landing at		
Southold, Inc. Project – Series 2000A),		
8.0%, 10–1–20	2,000	2,221,060
First Mortgage Fixed Rate Revenue Bonds		
(Jefferson's Ferry Project – Series 1999A),		
7.2%, 11–1–19	1,500	1,624,455
Trust Inverse Certificates, beneficial ownership in Tobacco		
Settlement Financing Corporation, (State of New York),		
Asset-Backed Revenue Bonds, Series 2003B–1C		
(State Contingency Contract Secured), (Fixed Rate),		
7.9828%, 6–1–10 (B)	7,500	8,967,900
The Port Authority of New York and New Jersey,		
Consolidated Bonds, One Hundred		
Twenty-Sixth Series,		
5.5%, 11–15–11	5,000	5,485,150
Dormitory Authority of the State of New York:		
Third General Resolution Revenue Bonds (State		
University Educational Facilities Issue), Series 2002B,		
5.25%, 11–15–23	3,500	3,785,600
Nyack Hospital Revenue Bonds, Series 1996		
6.25%, 7–1–13	1,500	1,486,245
City of Yonkers Industrial Development Agency,		
Civic Facility Revenue Bonds (St. John's Riverside		
Hospital Project):		
Series 2001B,		
7.125%, 7–1–31	1,455	1,510,203
Series 2001A,		
7.125%, 7–1–31	1,000	1,037,940
		33,294,788

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
North Carolina – 2.04%		
North Carolina Eastern Municipal Power Agency, Power System Revenue Bonds: Series 1999 D, 6.7%, 1–1–19	\$2,500	\$ 2,783,800
Refunding Series 2003 C, 5.5%, 1–1–14	2,000	2,157,680
Refunding Series 2003 A, 5.5%, 1–1–12	2,000	2,145,800
City of Durham, North Carolina, Multifamily Housing Revenue Bonds (Ivy Commons Project), Series 1997, 8.0%, 3–1–29	1,990	1,511,305
		<u>8,598,585</u>
Ohio – 1.16%		
City of Toledo, Ohio, Multifamily Housing Mortgage Revenue Bonds, Series 1998-A (Hillcrest Apartments Project), 6.125%, 12–1–29	3,900	3,154,515
Toledo Lucas County Port Authority, Development Revenue Bonds (Northwest Ohio Bond Fund), Series 2004C (Toledo Express Airport Project), 6.375%, 11–15–32	1,650	1,748,621
		<u>4,903,136</u>
Oklahoma – 0.94%		
The Oklahoma Development Finance Authority, Continuing Care Retirement Community, Revenue Bonds (Inverness Village Project), Fixed Rate Revenue Bonds, Series 2002A, 8.0%, 2–1–32	4,000	3,313,720
Trustees of the Oklahoma Ordnance Works Authority, Industrial Development Revenue Refunding Bonds (A.P. Green Industries, Inc. Project), Series 1992, 8.5%, 5–1–08 (A)	1,600	664,000
		<u>3,977,720</u>
Oregon – 1.28%		
Gilliam County, Oregon, Variable Rate Demand Solid Waste Disposal Revenue Bonds (Waste Management Project), Series 2000A, 4.15%, 8–1–25	5,000	5,061,150
Myrtle Creek Building Authority, Gross Revenue Bonds, Series 1996A (Myrtle Creek Golf Course Project), 8.0%, 6–1–21 (A)	3,000	349,710
		<u>5,410,860</u>

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Pennsylvania – 3.26%		
Allegheny County Hospital Development Authority, Health System Revenue Bonds (West Penn Allegheny Health System), Series 2000B, 9.25%, 11–15–22	\$5,000	\$ 5,992,600
The Borough of Langhorne Manor, Higher Education and Health Authority (Bucks County, Pennsylvania), Hospital Revenue Bonds, Series of 1992 (The Lower Bucks Hospital):		
7.3%, 7–1–12	3,800	3,831,464
7.35%, 7–1–22	1,400	1,411,466
Allegheny County Industrial Development Authority (Pennsylvania), Environmental Improvement Revenue Bonds (USX Corporation Project), Refunding Series A 1994,		
6.7%, 12–1–20	2,495	2,536,342
		<u>13,771,872</u>
Rhode Island – 0.82%		
City of Providence, Rhode Island, Special Obligation Tax Increment Bonds, Series D, 6.65%, 6–1–16	1,955	2,016,250
Rhode Island Health and Educational Building Corporation, Hospital Financing Revenue Bonds, St. Joseph Health Services of Rhode Island Issue, Series 1999,		
5.75%, 10–1–14	1,400	1,450,834
		<u>3,467,084</u>
South Carolina – 3.59%		
Tobacco Settlement Revenue Management Authority, Tobacco Settlement Asset-Backed Bonds, Series 2001B (Tax-Exempt), 6.375%, 5–15–28	11,750	12,680,130
McCormick County, South Carolina, Hospital Facilities Revenue Refunding and Improvement Bonds, Series 1997 (McCormick Health Care Center Project),		
7.0%, 3–1–18	2,530	2,484,637
		<u>15,164,767</u>
Tennessee – 2.70%		
Upper Cumberland Gas Utility District (of Cumberland County, Tennessee): Gas System Revenue Refunding Bonds, Series 2005:		
6.9%, 5–1–29	3,750	3,719,550
6.8%, 5–1–19	1,955	1,944,599
Gas System Revenue Bonds, Series 1996,		
7.0%, 3–1–16	1,400	1,503,712

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Tennessee – (Continued)		
The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee, Hospital Revenue Bonds (Wellmont Health System Project), Series 2002, 6.25%, 9–1–32	\$3,930	\$ 4,239,252
		11,407,113
Texas – 9.09%		
Dallas-Fort Worth International Airport Facility Improvement Corporation, American Airlines, Inc.: Revenue Refunding Bonds: Series 2000A, 8.5%, 5–1–29	3,500	3,463,320
Series 2000C, 6.15%, 5–1–29	2,500	2,365,100
Revenue Bonds, Series 1999, 6.375%, 5–1–35	5,000	3,453,300
North Central Texas Health Facilities Development Corporation, Retirement Facility Revenue Bonds (Northwest Senior Housing Corporation – Edgemere Project), Series 1999A, Fixed Rate Bonds: 7.5%, 11–15–29	4,000	4,346,760
7.25%, 11–15–19	1,000	1,083,380
Lubbock Health Facilities Development Corporation, Fixed Rate First Mortgage Revenue Bonds (Carillon, Inc. Project), Series 1999A, 6.5%, 7–1–19 (A)	6,000	5,049,900
Tarrant County Housing Finance Corporation, Multifamily Housing Revenue Notes (Quail Ridge Apartments Project), Series 2002A, 6.25%, 4–1–07	4,100	4,099,262
Lufkin Health Facilities Development Corporation, Health System Revenue and Refunding Bonds (Memorial Health System of East Texas), Series 1995, 6.875%, 2–15–26	3,605	3,725,046
Travis County Health Facilities Development Corporation, Retirement Facility Revenue Bonds (Querencia at Barton Creek Project), Series 2005A Fixed Rate Bonds: 5.65%, 11–15–35	1,250	1,221,625
5.0%, 11–15–14	835	833,748
4.9%, 11–15–13	835	829,447
5.5%, 11–15–25	500	493,385

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Texas (Continued)		
Cities of Dallas and Fort Worth, Texas, Dallas/Fort Worth International Airport, Joint Revenue Bonds, Series 2003A, 5.5%, 11-1-21	\$3,000	\$ 3,230,520
City of Houston Health Facilities, Development Corporation, Retirement Facility Revenue Bonds (Buckingham Senior Living Community, Inc. Project), Series 2004A, Fixed Rate Bonds, 7.0%, 2-15-26	1,500	1,607,520
Alvarado Industrial Development Corporation, Industrial Development Revenue Bonds (Rich-Mix Products of Texas, Inc. Project), Series 1996, 7.75%, 3-1-10	1,555	1,561,889
Decatur Hospital Authority, Hospital Revenue Bonds (Wise Regional Health System), Series 2004A, 5.625%, 9-1-13	1,000	1,025,970
		38,390,172
Utah – 0.23%		
Carbon County, Utah, Solid Waste Disposal Facility Revenue Refunding Bonds (Sunnyside Cogeneration Associates Project): Series 1999A, 7.1%, 8-15-23	837	839,821
Series 1999B, 0.0%, 8-15-24	390	109,485
		949,306
Virginia – 3.20%		
Norfolk Redevelopment and Housing Authority: Multifamily Rental Housing Facility Revenue Bonds, Series 1996 (1016 Limited Partnership – Sussex Apartments Project), 8.0%, 9-1-26	3,295	3,419,848
First Mortgage Revenue Bonds (Fort Norfolk Retirement Community, Inc. – Harbor's Edge Project), Series 2004A: 6.125%, 1-1-35	1,100	1,109,515
6.0%, 1-1-25	500	506,665

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

MUNICIPAL BONDS (Continued)	Principal Amount in Thousands	Value
Virginia (Continued)		
Pocahontas Parkway Association, Route 895 Connector, Toll Road Revenue Bonds, Senior Capital Appreciation Bonds, Series 1998B, 0.0%, 8–15–18	\$9,000	\$ 4,441,950
Industrial Development Authority of King George County, Virginia, Variable Rate Demand Solid Waste Disposal Revenue Bonds (King George Landfill, Inc. Project), Series 2003A, 4.1%, 6–1–23	4,000	4,042,320
		<u>13,520,298</u>
Washington – 1.16%		
Port of Anacortes, Washington, Revenue and Refunding Bonds, 1998 Series A (AMT), 5.625%, 9–1–16	3,490	3,646,701
Housing Authority of the City of Seattle, Low-Income Housing Assistance Revenue Bonds, 1995 (GNMA Collateralized Mortgage Loan – Kin On Project), 7.4%, 11–20–36	1,142	1,252,580
		<u>4,899,281</u>
Wisconsin – 0.46%		
City of Superior, Wisconsin, Water Supply Facilities Revenue Refunding Bonds (Superior Water, Light and Power Company Project), Series 1996, 6.125%, 11–1–21	1,910	1,943,864
Wyoming – 0.19%		
Cheyenne Regional Airport Board, First Mortgage Bonds, Tax-Exempt Revenue Refunding Bonds, Series 2005B (AMT): 5.0%, 6–15–16	460	452,861
4.75%, 6–15–14	330	327,660
		<u>780,521</u>
TOTAL MUNICIPAL BONDS – 94.51%		\$ 399,335,335
(Cost: \$391,908,829)		

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

SHORT-TERM SECURITIES	Principal Amount in Thousands	Value
Commercial Paper – 0.04%		
Forest and Paper Products		
Sonoco Products Co., 3.94%, 10–3–05	\$ 149	<u>\$ 148,967</u>
Municipal Obligations		
Arizona – 0.02%		
The Industrial Development Authority of the County of Maricopa, Variable Rate Demand Multifamily Housing Revenue Bonds (Gran Victoria Housing LLC Project), Series 2000A (Fannie Mae), 2.74%, 10–6–05	100	<u>100,000</u>
Colorado – 2.51%		
Colorado Agricultural Development Authority, Adjustable Rate Industrial Development Revenue Bonds (Royal Crest Dairy, Inc. Project), Series 1998 (UMB Bank, Colorado), 3.0%, 10–5–05	5,600	5,600,000
Exempla General Improvement District, City of Lafayette, Colorado, Special Improvement District No. 02–01, Special Assessment Revenue Refunding and Improvement Bonds, Series 2002 (Wells Fargo Bank, N. A.), 2.80%, 10–6–05	4,200	4,200,000
Colorado Educational and Cultural Facilities Authority, Variable Rate Demand Public Radio Revenue Bonds (Community Wireless of Park City, Inc. Project), Series 2003 (U.S. Bank, National Association), 2.80%, 10–5–05	790	<u>790,000</u> <u>10,590,000</u>
Total Municipal Obligations – 2.53%		10,690,000
TOTAL SHORT-TERM SECURITIES – 2.57% (Cost: \$10,838,967)		\$ 10,838,967
TOTAL INVESTMENT SECURITIES – 97.08% (Cost: \$402,747,796)		\$410,174,302
CASH AND OTHER ASSETS, NET OF LIABILITIES – 2.92%		12,350,764
NET ASSETS – 100.00%		\$422,525,066

See Notes to Schedule of Investments on page 29.

The Investments of Municipal High Income Fund

September 30, 2005

Notes to Schedule of Investments

(A) Non-income producing as the issuer has either missed its most recent interest payment or declared bankruptcy.

(B) The interest rate is subject to change periodically and inversely based upon prevailing market rates. The interest rate shown is the rate in effect at September 30, 2005.

See Note 1 to financial statements for security valuation and other significant accounting policies concerning investments.

See Note 3 to financial statements for cost and unrealized appreciation and depreciation of investments owned for Federal income tax purposes.

Statement of Assets and Liabilities

MUNICIPAL HIGH INCOME FUND

September 30, 2005

(In Thousands, Except for Per Share Amounts)

ASSETS

Investment securities – at value (cost – \$402,748) (Notes 1 and 3)	\$410,174
Cash	1
Receivables:	
Interest	7,992
Investment securities sold	4,771
Fund shares sold	754
Prepaid and other assets	31
Total assets	<u>423,723</u>

LIABILITIES

Payable to Fund shareholders	821
Dividends payable	171
Accrued service fee (Note 2)	80
Accrued shareholder servicing (Note 2)	46
Accrued accounting services fee (Note 2)	11
Accrued management fee (Note 2)	6
Accrued distribution fee (Note 2)	2
Other	61
Total liabilities	<u>1,198</u>
Total net assets	<u>\$422,525</u>

NET ASSETS

\$1.00 par value capital stock:	
Capital stock	\$ 84,853
Additional paid-in capital	360,708
Accumulated undistributed income (loss):	
Accumulated undistributed net investment income	328
Accumulated undistributed net realized loss	
on investment transactions	(30,791)
Net unrealized appreciation in value of investments	7,427
Net assets applicable to outstanding units of capital	<u>\$422,525</u>
Net asset value per share (net assets divided by shares outstanding):	
Class A	\$4.98
Class B	\$4.98
Class C	\$4.98
Class Y	\$4.98
Capital shares outstanding:	
Class A	81,661
Class B	1,331
Class C	1,841
Class Y	20
Capital shares authorized	300,000

See Notes to Financial Statements.

Statement of Operations

MUNICIPAL HIGH INCOME FUND

For the Fiscal Year Ended September 30, 2005

(In Thousands)

INVESTMENT INCOME

Income (Note 1B):	
Interest and amortization	\$25,059
Expenses (Note 2):	
Investment management fee	2,139
Service fee:	
Class A	881
Class B	15
Class C	18
Shareholder servicing:	
Class A	380
Class B	11
Class C	15
Class Y	—*
Legal fees	139
Accounting services fee	129
Distribution fee:	
Class A	18
Class B	46
Class C	54
Custodian fees	26
Audit fees	24
Other	175
Total expenses	4,070
Net investment income	20,989

REALIZED AND UNREALIZED GAIN

ON INVESTMENTS (NOTES 1 AND 3)

Realized net gain on investments	1,811
Unrealized appreciation in value of investments during the period	6,491
Net gain on investments	8,302
Net increase in net assets resulting from operations	\$29,291

*Not shown due to rounding.

Statement of Changes in Net Assets

MUNICIPAL HIGH INCOME FUND

(In Thousands)

	For the fiscal year ended September 30,	
	2005	2004
INCREASE (DECREASE) IN NET ASSETS		
Operations:		
Net investment income	\$ 20,989	\$ 21,787
Realized net gain (loss) on investments	1,811	(6,017)
Unrealized appreciation	6,491	9,569
Net increase in net assets resulting from operations	29,291	25,339
Distributions to shareholders from net investment income (Note 1D): ⁽¹⁾		
Class A	(20,363)	(21,442)
Class B	(264)	(265)
Class C	(304)	(229)
Class Y	(5)	(7)
Realized gains on investment transactions:		
Class A	(—)	(—)
Class B	(—)	(—)
Class C	(—)	(—)
Class Y	(—)	(—)
	(20,936)	(21,943)
Capital share transactions (Note 5)	17,200	(32,989)
Total increase (decrease)	25,555	(29,593)
NET ASSETS		
Beginning of period	396,970	426,563
End of period	\$422,525	\$396,970
Undistributed net investment income	\$ 328	\$ 275

(1) See "Financial Highlights" on pages 33 - 36.

Financial Highlights

MUNICIPAL HIGH INCOME FUND

Class A Shares

For a Share of Capital Stock Outstanding Throughout Each Period:

	For the fiscal year ended September 30,				
	2005	2004	2003	2002	2001
Net asset value,					
beginning of period	\$4.88	\$4.83	\$4.95	\$4.96	\$4.92
Income (loss) from					
investment operations:					
Net investment income	0.26	0.26	0.26	0.26	0.28
Net realized and unrealized					
gain (loss) on investments	0.10	0.05	(0.12)	(0.01)	0.04
Total from investment operations	0.36	0.31	0.14	0.25	0.32
Less distributions from:					
Net investment income	(0.26)	(0.26)	(0.26)	(0.26)	(0.28)
Capital gains	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Total distributions	(0.26)	(0.26)	(0.26)	(0.26)	(0.28)
Net asset value, end of period	\$4.98	\$4.88	\$4.83	\$4.95	\$4.96
Total return ⁽¹⁾	7.45%	6.66%	3.02%	5.35%	6.64%
Net assets, end of period					
(in millions)	\$407	\$386	\$407	\$431	\$419
Ratio of expenses to					
average net assets	0.97%	0.95%	0.96%	1.03%	1.02%
Ratio of net investment income					
to average net assets	5.18%	5.41%	5.54%	5.39%	5.61%
Portfolio turnover rate	24%	28%	23%	23%	22%

(1) Total return calculated without taking into account the sales load deducted on an initial purchase.

Financial Highlights

MUNICIPAL HIGH INCOME FUND

Class B Shares

For a Share of Capital Stock Outstanding Throughout Each Period:

	For the fiscal year ended September 30,				
	2005	2004	2003	2002	2001
Net asset value,					
beginning of period	\$4.88	\$4.83	\$4.95	\$4.96	\$4.92
Income (loss) from					
investment operations:					
Net investment income	0.21	0.22	0.22	0.22	0.23
Net realized and unrealized gain					
(loss) on investments	0.10	0.05	(0.12)	(0.01)	0.04
Total from investment operations	0.31	0.27	0.10	0.21	0.27
Less distributions from:					
Net investment income	(0.21)	(0.22)	(0.22)	(0.22)	(0.23)
Capital gains	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Total distributions	(0.21)	(0.22)	(0.22)	(0.22)	(0.23)
Net asset value, end of period	\$4.98	\$4.88	\$4.83	\$4.95	\$4.96
Total return	6.53%	5.75%	2.15%	4.46%	5.71%
Net assets, end of period					
(in millions)	\$7	\$6	\$6	\$5	\$3
Ratio of expenses to average					
net assets	1.83%	1.81%	1.80%	1.85%	1.91%
Ratio of net investment income					
to average net assets	4.31%	4.55%	4.71%	4.56%	4.68%
Portfolio turnover rate	24%	28%	23%	23%	22%

See Notes to Financial Statements.

Financial Highlights

MUNICIPAL HIGH INCOME FUND

Class C Shares

For a Share of Capital Stock Outstanding Throughout Each Period:

	For the fiscal year ended September 30,				
	2005	2004	2003	2002	2001
Net asset value,					
beginning of period	\$4.88	\$4.83	\$4.95	\$4.96	\$4.92
Income (loss) from					
investment operations:					
Net investment income	0.21	0.22	0.22	0.22	0.23
Net realized and unrealized gain					
(loss) on investments	0.10	0.05	(0.12)	(0.01)	0.04
Total from investment operations	0.31	0.27	0.10	0.21	0.27
Less distributions from:					
Net investment income	(0.21)	(0.22)	(0.22)	(0.22)	(0.23)
Capital gains	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Total distributions	(0.21)	(0.22)	(0.22)	(0.22)	(0.23)
Net asset value, end of period	<u>\$4.98</u>	<u>\$4.88</u>	<u>\$4.83</u>	<u>\$4.95</u>	<u>\$4.96</u>
Total return	6.49%	5.71%	2.16%	4.49%	5.74%
Net assets, end of period					
(in millions)	\$9	\$5	\$5	\$5	\$3
Ratio of expenses to					
average net assets	1.87%	1.85%	1.80%	1.84%	1.84%
Ratio of net investment income					
to average net assets	4.26%	4.49%	4.70%	4.58%	4.72%
Portfolio turnover rate	24%	28%	23%	23%	22%

See Notes to Financial Statements.

Financial Highlights

MUNICIPAL HIGH INCOME FUND

Class Y Shares

For a Share of Capital Stock Outstanding Throughout Each Period:

	For the fiscal year ended September 30,				
	2005	2004	2003	2002	2001
Net asset value,					
beginning of period	\$4.88	\$4.83	\$4.95	\$4.96	\$4.92
Income (loss) from					
investment operations:					
Net investment income	0.27	0.27	0.27	0.26	0.27
Net realized and unrealized gain					
(loss) on investments	0.10	0.05	(0.12)	(0.01)	0.04
Total from investment operations	0.37	0.32	0.15	0.25	0.31
Less distributions from:					
Net investment income	(0.27)	(0.27)	(0.27)	(0.26)	(0.27)
Capital gains	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Total distributions	(0.27)	(0.27)	(0.27)	(0.26)	(0.27)
Net asset value, end of period	\$4.98	\$4.88	\$4.83	\$4.95	\$4.96
Total return	7.67%	6.87%	3.17%	5.35%	6.45%
Net assets, end of period					
(in thousands)	\$97	\$83	\$8,801	\$8,646	\$2
Ratio of expenses to					
average net assets	0.76%	0.75%	0.80%	0.63%	1.93%
Ratio of net investment income					
to average net assets	5.38%	5.78%	5.76%	5.68%	4.72%
Portfolio turnover rate	24%	28%	23%	23%	22%

See Notes to Financial Statements.

Notes to Financial Statements

September 30, 2005

NOTE 1 – Significant Accounting Policies

Waddell & Reed Advisors Municipal High Income Fund, Inc. (the Fund) is registered under the Investment Company Act of 1940 as a diversified, open-end management investment company. Its investment objective is to seek to provide a high level of income which is not subject to Federal income tax. The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The policies are in conformity with accounting principles generally accepted in the United States of America.

- A. Security valuation** – Municipal bonds and the taxable obligations in the Fund's investment portfolio are not listed or traded on any securities exchange. Therefore, municipal bonds are valued using a pricing system provided by a pricing service or dealer in bonds. Restricted securities and securities for which market quotations are not readily available or are deemed not to be reliable because of significant events or circumstances identified between the closing of their principal markets and the closing of the New York Stock Exchange are valued as determined in good faith under procedures established by and under the general supervision of the Fund's Board of Directors. Short-term debt securities, whether taxable or nontaxable, are valued at amortized cost, which approximates market value.
- B. Security transactions and related investment income** – Security transactions are accounted for on the trade date (date the order to buy or sell is executed). Securities gains and losses are calculated on the identified cost basis. Original issue discount (as defined in the Internal Revenue Code) and premiums on the purchase of bonds are amortized for both financial and tax reporting purposes over the remaining lives of the bonds. Interest income is recorded on the accrual basis. See Note 3 – Investment Security Transactions.
- C. Federal income taxes** – The Fund intends to distribute all of its net investment income and capital gains to its shareholders and otherwise qualify as a regulated investment company under Subchapter M of the Internal Revenue Code. The Fund intends to pay distributions as required to avoid imposition of excise tax. Accordingly, provision has not been made for Federal income taxes. In addition, the Fund intends to meet requirements of the Internal Revenue Code which will permit it to pay dividends from net investment income, substantially all of which will be exempt from Federal income tax. See Note 4 – Federal Income Tax Matters.
- D. Dividends and distributions** – All of the Fund's net investment income is declared and recorded by the Fund as dividends payable on each day to shareholders of record as of the close of the preceding business day. Net investment income dividends and capital gains distributions are determined in accordance with income tax regulations which may differ from accounting principles generally accepted in the United States of America. These differences are due to differing treatments for items such as deferral of wash sales and post-October losses, net operating losses and expiring capital loss carryovers.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

NOTE 2 – Investment Management and Payments to Affiliated Persons

Waddell & Reed Investment Management Company (WRIMCO), a wholly owned subsidiary of Waddell & Reed, Inc. (W&R), serves as the Fund's investment manager. The Fund pays a fee for investment management services. The fee is computed and paid daily based on the net asset value at the close of business. The fee is payable by the Fund at the annual rates of: 0.525% of net assets up to \$500 million, 0.50% of net assets over \$500 million and up to \$1 billion, 0.45% of net assets over \$1 billion and up to \$1.5 billion, and 0.40% of net assets over \$1.5 billion.

The Fund has an Accounting Services Agreement with Waddell & Reed Services Company (WRSCO), a wholly owned subsidiary of W&R. Under the agreement, WRSCO acts as the agent in providing accounting services and assistance to the Fund and pricing daily the value of shares of the Fund. For these services, the Fund pays WRSCO a monthly fee of one-twelfth of the annual fee shown in the following table:

Accounting Services Fee		
Average Net Asset Level (in millions)		Annual Fee Rate for Each Level
From \$	0 to \$ 10	\$ 0
From \$	10 to \$ 25	\$ 11,500
From \$	25 to \$ 50	\$ 23,100
From \$	50 to \$ 100	\$ 35,500
From \$	100 to \$ 200	\$ 48,400
From \$	200 to \$ 350	\$ 63,200
From \$	350 to \$ 550	\$ 82,500
From \$	550 to \$ 750	\$ 96,300
From \$	750 to \$1,000	\$121,600
	\$1,000 and Over	\$148,500

In addition, for each class of shares in excess of one, the Fund pays WRSCO a monthly per-class fee equal to 2.5% of the monthly accounting services base fee.

The Fund also pays monthly a fee at the annual rate of 0.01% or one basis point for the first \$1 billion of net assets with no fee charged for net assets in excess of \$1 billion.

For Class A, Class B and Class C shares, the Fund pays WRSCO a monthly per account charge for shareholder servicing of \$1.6958 for each shareholder account which was in existence at any time during the prior month. With respect to Class Y shares, the Fund pays WRSCO a monthly fee at an annual rate of 0.15% of the average daily net assets of the class for the preceding month. The Fund also reimburses W&R and WRSCO for certain out-of-pocket costs for all classes.

As principal underwriter for the Fund's shares, W&R received gross sales commissions for Class A shares (which are not an expense of the Fund) of \$811,288. A contingent deferred sales charge (CDSC) may be assessed against a shareholder's redemption amount of Class A, Class B and Class C shares and paid to W&R. During the period ended September 30, 2005, W&R received \$1,156, \$11,713 and \$6,173 in CDSC for Class A, Class B and Class C shares, respectively. With respect to Class A, Class B and Class C shares, W&R paid sales commissions of \$534,148 and all expenses in connection with the sale of Fund shares, except for registration fees and related expenses.

Under a Distribution and Service Plan for Class A shares adopted by the Fund pursuant to Rule 12b-1 under the Investment Company Act of 1940, the Fund may pay monthly a distribution and/or service fee to W&R in an amount not to exceed 0.25% of the Fund's Class A average annual net assets. The fee is to be paid to reimburse W&R for amounts it expends in connection with the distribution of the Class A shares and/or provision of personal services to Fund shareholders and/or maintenance of shareholder accounts.

Under the Distribution and Service Plan adopted by the Fund for Class B and Class C shares, respectively, the Fund may pay W&R a service fee of up to 0.25%, on an annual basis, of the average daily net assets of the class to compensate W&R for providing services to shareholders of that class and/or maintaining shareholder accounts for that class and a distribution fee of up to 0.75%, on an annual basis, of the average daily net assets of the class to compensate W&R for distributing the shares of that class. The Class B Plan and the Class C Plan each permit W&R to receive compensation, through the distribution and service fee, respectively, for its distribution activities for that class, which are similar to the distribution activities described with respect to the Class A Plan, and for its activities in providing personal services to shareholders of that class and/or maintaining shareholder accounts of that class, which are similar to the corresponding activities for which it is entitled to reimbursement under the Class A Plan.

The Fund paid Directors' regular compensation of \$23,932, which are included in other expenses. The Fund pays Frederick Vogel III additional compensation for his service as lead independent director. For the fiscal year ended September 30, 2005, that amount was \$161.

W&R is a subsidiary of Waddell & Reed Financial, Inc., a public holding company, and a direct subsidiary of Waddell & Reed Financial Services, Inc., a holding company.

NOTE 3 – Investment Security Transactions

Purchases of investment securities, other than U.S. government obligations and short-term securities, aggregated \$113,943,309, while proceeds from maturities and sales aggregated \$90,668,703. Purchases of short-term securities aggregated \$1,469,009,070, while proceeds from maturities and sales aggregated \$1,481,859,180. No U.S. government obligations were purchased or sold during the fiscal year ended September 30, 2005.

For Federal income tax purposes, cost of investments owned at September 30, 2005 was \$402,419,926, resulting in net unrealized appreciation of \$7,754,376, of which \$19,652,881 related to appreciated securities and \$11,898,505 related to depreciated securities.

NOTE 4 – Federal Income Tax Matters

For Federal income tax purposes, the Fund's distributed and undistributed earnings and profit for the fiscal year ended September 30, 2005 and the related capital loss carryover and post-October activity were as follows:

Net ordinary income	\$20,916,124
Distributed ordinary income	20,943,047
Undistributed ordinary income	739,127
Realized long-term capital gains	—
Distributed long-term capital gains	—
Undistributed long-term capital gains	—
Capital loss carryover	5,048,012
Post-October losses deferred	—

Internal Revenue Code regulations permit the Fund to defer into its next fiscal year net capital losses or net long-term capital losses incurred between each November 1 and the end of its fiscal year (post-October losses).

Capital loss carryovers are available to offset future realized capital gain net income for Federal income tax purposes. The following shows the totals by year in which the capital loss carryovers will expire if not utilized.

September 30, 2009	\$ 6,187,770
September 30, 2010	11,473,462
September 30, 2011	3,929,709
September 30, 2012	4,152,198
September 30, 2013	5,048,012
Total carryover	<u>\$30,791,151</u>

NOTE 5 – Multiclass Operations

The Fund currently offers four classes of shares, Class A, Class B, Class C and Class Y, each of which have equal rights as to assets and voting privileges. Class Y shares are not subject to a sales charge on purchases, are not subject to a Rule 12b-1 Distribution and Service Plan and are subject to a separate shareholder servicing fee structure. A comprehensive discussion of the terms under which shares of each class are offered is contained in the Prospectus and the Statement of Additional Information for the Fund.

Income, non-class specific expenses, and realized and unrealized gains and losses are allocated daily to each class of shares based on the value of their relative net assets as of the beginning of each day adjusted for the prior day's capital share activity. Transactions in capital stock are summarized below. Amounts are in thousands.

	For the fiscal year ended September 30,	
	2005	2004
Shares issued from sale of shares:		
Class A	9,506	5,688
Class B	296	186
Class C	1,039	491
Class Y	2	16
Shares issued from reinvestment of dividends and/or capital gains distribution:		
Class A	3,215	3,429
Class B	41	44
Class C	55	44
Class Y	1	—*
Shares redeemed:		
Class A	(10,172)	(14,222)
Class B	(186)	(276)
Class C	(340)	(427)
Class Y	(1)	(1,820)
Increase (decrease) in outstanding capital shares	3,456	(6,847)
Value issued from sale of shares:		
Class A	\$47,150	\$ 27,576
Class B	1,467	900
Class C	5,143	2,375
Class Y	11	77
Value issued from reinvestment of dividends and/or capital gains distribution:		
Class A	15,920	16,615
Class B	203	213
Class C	274	211
Class Y	5	1
Value redeemed:		
Class A	(50,364)	(68,798)
Class B	(923)	(1,334)
Class C	(1,683)	(2,072)
Class Y	(3)	(8,753)
Increase (decrease) in outstanding capital	\$17,200	\$(32,989)

*Not shown due to rounding.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders,
Waddell & Reed Advisors Municipal High Income Fund, Inc.:

We have audited the accompanying statement of assets and liabilities, including the schedule of investments, of Waddell & Reed Advisors Municipal High Income Fund, Inc. (the "Fund") as of September 30, 2005, and the related statement of operations for the fiscal year then ended, the statements of changes in net assets for each of the two fiscal years in the period then ended, and the financial highlights for the periods presented. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. The Fund is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our procedures included confirmation of securities owned as of September 30, 2005, by correspondence with the custodian. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Waddell & Reed Advisors Municipal High Income Fund, Inc. as of September 30, 2005, the results of its operations for the fiscal year then ended, the changes in its net assets for each of the two fiscal years in the period then ended, and its financial highlights for the periods presented, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP
Kansas City, Missouri
November 16, 2005

Income Tax Information

September 30, 2005

Dividends are declared and recorded by the Fund on each day the New York Stock Exchange is open for business. Dividends are paid monthly.

Exempt Interest Dividends – The exempt interest portion of dividends paid represents the distribution of state and municipal bond interest and is exempt from Federal income taxation.

The table below shows the taxability of dividends paid during the fiscal year ended September 30, 2005:

Record Date	PERCENTAGE OF AMOUNTS PAID REPORTABLE AS:					
	For Individuals			For Corporations		
	Non-Qualifying	Long-Term Capital Gain	Exempt Interest	Non-Qualifying	Long-Term Capital Gain	Exempt Interest
Class A, B, C and Y						
October 2004 through December 2004	1.32998%	—%	98.67002%	1.32998%	—%	98.67002%
January 2005 through September 2005	1.12463%	—%	98.87537%	1.12463%	—%	98.87537%

NON-QUALIFYING DIVIDENDS – The non-qualifying portion of distributions represents the taxable portion of dividends paid and does not qualify for the dividends received deduction for corporations.

The actual taxable amount of dividends will be reported to you on Form 1099-DIV after the close of the applicable calendar year.

Income from the Fund may be subject to the alternative minimum tax. Shareholders are advised to consult with their tax adviser concerning the tax treatment of dividends and distributions from the Fund.

The Board of Directors of Waddell & Reed Advisors Municipal High Income Fund, Inc.

Each of the individuals listed below serves as a director for the Fund, and for the other portfolios within the Waddell & Reed Advisors Funds, Waddell & Reed InvestEd Portfolios, Inc. and W&R Target Funds, Inc. (the "Advisors Fund Complex"), except that Mr. Hechler is not a Director of W&R Target Funds, Inc. The Advisors Fund Complex, together with the Ivy Family of Funds, make up the Waddell & Reed Fund Complex. The Ivy Family of Funds consists of the portfolios in the Ivy Funds and Ivy Funds, Inc.

The interested directors are "interested" by virtue of their current or former engagement as officers of Waddell & Reed Financial, Inc. (WDR) or its wholly-owned subsidiaries, including the funds' investment advisor, Waddell & Reed Investment Management Company (WRIMCO); the funds' principal underwriter, Waddell & Reed, Inc. (W&R); and the funds' transfer agent, Waddell & Reed Services Company (WRSCO), as well as by virtue of their personal ownership of shares of WDR. The other directors (more than a majority of the total number) are disinterested; that is, they are not employees or officers of, and have no financial interest in, WDR or any of its wholly-owned subsidiaries, including W&R, WRIMCO and WRSCO. Each Director serves an indefinite term, until he or she dies, resigns, is removed or becomes disqualified.

Additional Information about Directors

The Statement of Additional Information (SAI) for Waddell & Reed Advisors Municipal High Income Fund, Inc. includes additional information about Fund directors. The SAI is available without charge, upon request, by calling 1.888.WADDELL. It is also available on the Waddell & Reed website, www.waddell.com.

DISINTERESTED DIRECTORS

James M. Concannon (58)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 44

Director since: 1997

Director of Funds in the Fund Complex since: 1997

Principal Occupations During Past 5 Years: Professor of Law, Washburn Law School; formerly, Dean, Washburn Law School (until 2001)

Other Directorships held by Director: Director, Kansas Legal Services for Prisoners, Inc.

John A. Dillingham (66)

4040 Northwest Claymont Drive, Kansas City, MO 64116

Position held with Fund: Director

Number of portfolios overseen by Director: 44

Director since: 1997

Director of Funds in the Fund Complex since: 1997

Principal Occupations During Past 5 Years: President and Director, JoDill Corp. and Dillingham Enterprises, Inc., both farming enterprises; President, Missouri Department of Justice

Other Directorships held by Director: Director, Salvation Army; Advisory Director, UMB Northland Board (financial services)

David P. Gardner (72)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 44

Director since: 1998

Director of Funds in the Fund Complex since: 1998

Principal Occupation During Past 5 Years: Senior Advisor to the President, J. Paul Getty Trust; formerly, Professor, University of Utah (until 2005)

Other Directorships held by Director: None

Linda K. Graves (52)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 44

Director since: 1995

Director of Funds in the Fund Complex since: 1995

Principal Occupation During Past 5 Years: First Lady of Kansas (until 2003)

Other Directorships held by Director: Chairman and Director, Greater Kansas City Community Foundation

Joseph Harroz, Jr. (38)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 71

Director since: 1998

Director of Funds in the Fund Complex since: 1998

Principal Occupations During Past 5 Years: Vice President and General Counsel of the Board of Regents, University of Oklahoma; Adjunct Professor, University of Oklahoma Law School; Managing Member, Harroz Investments, LLC, commercial enterprise investments; formerly, Consultant, MTV Associates (2004)

Other Directorships held by Director: Director and Shareholder, Valliance Bank; Director, Ivy Funds, Inc.; Trustee, Ivy Funds

John F. Hayes (85)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 44

Director since: 1988

Director of Funds in the Fund Complex since: 1988

Principal Occupation During Past 5 Years: Shareholder, Gilliland & Hayes, PA, a law firm; formerly, Chairman, Gilliland & Hayes (until 2003)

Other Directorships held by Director: Director, Central Bank & Trust; Director, Central Financial Corp. (banking)

Glendon E. Johnson (81)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 44

Director since: 1985

Director of Funds in the Fund Complex since: 1971

Principal Occupations During Past 5 Years: Retired

Other Directorships held by Director: None

Frank J. Ross, Jr. (52)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 44

Director since: 1996

Director of Funds in the Fund Complex since: 1996

Principal Occupation During Past 5 Years: Shareholder/Director, Polsinelli Shalton Welte Suelthaus, a law firm

Other Directorships held by Director: Director, Columbian Bank & Trust

Eleanor B. Schwartz (68)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Director

Number of portfolios overseen by Director: 71

Director since: 1995

Director of Funds in the Fund Complex since: 1995

Principal Occupations During Past 5 Years: Professor Emeritus, University of Missouri at Kansas City; formerly, Professor of Business Administration, University of Missouri at Kansas City (until 2003)

Other Directorships held by Director: Director, Ivy Funds, Inc.; Trustee, Ivy Funds

Frederick Vogel III (70)

6300 Lamar Avenue, Overland Park, KS 66202

Position held with Fund: Independent Chairman and Director

Number of portfolios overseen by Director: 44

Director since: 1985

Director of Funds in the Fund Complex since: 1971

Principal Occupation During Past 5 Years: Member, Board of Directors, The Terra Foundation for American Art (Chicago); Vice President, Treasurer and Trustee, The Layton Art Collection, Inc.; Member of the Directors Advisory Committee for American Art

Other Directorships held by Director: None

INTERESTED DIRECTORS

Robert L. Hechler (68)

6300 Lamar Avenue, Overland Park, KS 66202

Positions held with Fund: Director; formerly, President, Principal Financial Officer

Number of portfolios overseen by Director: 24

Director since: 1998

Director of Funds in the Fund Complex since: 1998

Principal Occupations During Past 5 Years: Consultant of WDR and W&R; formerly, Director of WDR (until 2003); formerly, Executive Vice President and Chief Operating Officer of WDR (until 2001); formerly, Chief Executive Officer, President, Director, Principal Financial Officer and Treasurer of W&R (until 2001); formerly, Director, Executive Vice President, Principal Financial Officer and Treasurer of WRIMCO (until 2001); formerly, Director and Treasurer of WRSCO (until 2001)

Other Directorships held by Director: None

Henry J. Herrmann (62)

6300 Lamar Avenue, Overland Park, KS 66202

Positions held with Fund: Director and President

Number of portfolios overseen by Director: 72

Director since: 1998; President since: 2001

Director of Funds in the Fund Complex since: 1998

Principal Occupation(s) During Past 5 Years: Chief Executive Officer of WDR; formerly, Chief Investment Officer and President of WDR (until 2005); formerly, President, Chief Executive Officer, Chairman and Chief Investment Officer of WRIMCO (until 2005); formerly, President, Chairman, Chief Executive Officer and Chief Investment Officer of Ivy Investment Management Company (IICO), an affiliate of WDR; President of each of the Funds in the Advisors Fund Complex; President of Ivy Funds, Inc.; President of Ivy Funds

Other Directorships held by Director: Director of WDR, W&R, WRIMCO, WRSCO, IICO; Director, Austin, Calvert & Flavin, an affiliate of WRIMCO; Director, Ivy Funds Distributor, Inc. (IFDI) an affiliate of WDR; Director, Ivy Funds, Inc.; Trustee, Ivy Funds

OFFICERS

Theodore W. Howard (63)

6300 Lamar Avenue, Overland Park, KS 66202

Positions held with Fund: Treasurer and Principal Accounting Officer since 1985; Vice President since 1987; Principal Financial Officer since 2002

Positions held with Funds in the Fund Complex: Treasurer and Principal Accounting Officer since 1976; Vice President since 1987; Principal Financial Officer since 2002

Principal Occupation(s) During Past 5 Years: Senior Vice President of WRSCO; Treasurer, Principal Accounting Officer, Vice President and Principal Financial Officer of each of the Funds in the Fund Complex; Vice President, Principal Financial Officer, Principal Accounting Officer and Treasurer of Ivy Funds and Ivy Funds, Inc.; formerly, Assistant Treasurer of Ivy Funds (until 2003); formerly, Vice President of WRSCO (until 2001)

Directorships held: None

Kristen A. Richards (37)

6300 Lamar Avenue, Overland Park, KS 66202

Positions held with Fund: Vice President, Secretary and Associate General Counsel since 2000

Positions held with Funds in the Fund Complex: Vice President, Secretary and Associate General Counsel since 2000

Principal Occupation(s) During Past 5 Years: Vice President, Associate General Counsel and Chief Compliance Officer of WRIMCO; Vice President, Associate General Counsel and Chief Compliance Officer of IICO; Vice President and Secretary of each of the Funds in the Fund Complex; Vice President and Secretary of Ivy Funds; formerly, Assistant Secretary of each of the funds in the Fund Complex (until 2000)

Directorships held: None

Daniel C. Schulte (39)

6300 Lamar Avenue, Overland Park, KS 66202

Positions held with Fund: Vice President, Assistant Secretary and General Counsel since 2000

Positions held with Funds in the Fund Complex: Vice President, Assistant Secretary and General Counsel since 2000

Principal Occupation(s) During Past 5 Years: Senior Vice President and General Counsel of WDR; Senior Vice President, General Counsel of W&R, WRIMCO and WRSCO, IICO; Vice President, General Counsel and Assistant Secretary of each of the Funds in the Fund Complex; Vice President, General Counsel and Assistant Secretary of Ivy Funds; formerly, Secretary of WDR, W&R, WRIMCO and WRSCO, IICO (until 2004)

Directorships held: None

Scott Schneider (37)

6300 Lamar Avenue, Overland Park, KS 66202

Positions held with Fund: Chief Compliance Officer since 2004

Positions held with Funds in the Fund Complex: Chief Compliance Officer since 2004

Principal Occupation(s) During Past 5 Years: Chief Compliance Officer for each of the Funds in the Fund Complex; formerly, Senior Attorney and Compliance Officer for each of the Funds in the Fund Complex (until 2004)

Directorships held: None

Renewal of Investment Management Agreement for Waddell & Reed Advisors Municipal High Income Fund, Inc.

At their August 23 and 24, 2005 meeting, the Directors, including all of the Disinterested Directors, considered and approved the renewal of the existing Management Agreement between WRIMCO and the Fund. The Disinterested Directors of the Fund were assisted in their review by independent legal counsel and met with such counsel separately from representatives of WRIMCO. The Disinterested Directors also received and considered a memorandum from their independent legal counsel regarding the Disinterested Directors' responsibilities in evaluating the Management Agreement. This memorandum explained the regulatory requirements pertaining to the Disinterested Directors' evaluation of WRIMCO and the Management Agreement.

Prior to the Board meeting, independent legal counsel sent to WRIMCO a request for information to be provided to the Directors in connection with their consideration of the continuance of the Management Agreement. WRIMCO provided materials to the Directors that included responses to those requests and other information WRIMCO believed was useful in evaluating continuation of the Management Agreement. The Directors also received reports prepared by an independent consultant, Lipper Inc., relating to the Fund's performance and expenses compared to the performance and expenses of a peer group of comparable funds. At the meeting, the Directors received a presentation from representatives of WRIMCO regarding services provided by it and its affiliates (collectively, W&R) to the Fund. In addition, during the course of the year, WRIMCO had provided information relevant to the Directors' consideration of the continuance of the Management Agreement.

Nature, Extent and Quality of Services Provided to the Fund

The Directors considered the nature, extent and quality of the services provided to the Fund pursuant to the Management Agreement and also the overall fairness of the Management Agreement.

The Directors considered WRIMCO's research and portfolio management capabilities and that W&R also provides oversight of day-to-day fund operations, including fund accounting and administration and assistance in meeting legal and regulatory requirements. The Directors also considered WRIMCO's practices regarding the selection and compensation of brokers and dealers that execute portfolio transactions for the Fund, those brokers' and dealers' provision of brokerage and research services to WRIMCO, and the benefits derived by the other funds in the Advisors Fund Complex and by other clients of WRIMCO from such services. The Directors also considered the favorable history, reputation, qualification and background of WRIMCO and W&R's extensive administrative, accounting and compliance infrastructure.

Fund Performance, Management Fee and Expense Ratio. The Directors considered the Fund's performance, both on an absolute basis and in relation to the performance of a peer group of comparable mutual funds, as selected by Lipper. The Fund's performance was also compared to relevant market indices and to a Lipper index, as applicable.

The Directors considered the management fees and total expenses of the Fund and also considered the Fund's management fees and total expenses in relation to the management fees and total expenses, respectively, of a peer group of comparable mutual funds. The Directors' review also included consideration of the Fund's management fees at various asset levels, which reflected breakpoints in the management fee structure and average account size information. In addition, the Directors considered that the Fund's investment management fees, if any, were the

same as the fees paid to WRIMCO (or its affiliate) by other mutual funds managed by WRIMCO (or its affiliate) with similar investment objectives, policies and strategies as the Fund (Similar Funds). The Directors also considered the subadvisory fees, if any, paid to WRIMCO (or its affiliate) by other mutual funds advised by WRIMCO (or its affiliate), as well as the management fees, if any, paid by other client accounts managed by WRIMCO (or its affiliate), with similar investment objectives, policies and strategies as the Fund (Other Accounts).

The Directors considered that Waddell & Reed Advisors Municipal High Income Fund's total return performance was higher than the peer group median for most periods and was higher than the Lipper index for the one- and ten-year periods.

The Directors considered the range and average of the management fees and expense ratios of the peer group. They considered that the Fund's management fee was lower than the peer group median and that the overall expense ratio was higher than the peer group median on an unadjusted basis but that, when adjusted for the Fund's smaller average account size, the Fund's overall expense ratio was lower than its peer group median. They also considered that, with the breakpoints in the fee schedule, the Fund's effective management fees at various asset levels were lower than the asset-weighted average for its peer group.

The Directors also considered that there were no Similar Funds or Other Accounts managed by WRIMCO or its affiliates with similar investment objectives, policies and strategies as the Fund.

Profitability and Economies of Scale

The Directors also considered that the Fund's management fee structure includes breakpoints that provide for a reduction of payments to reflect anticipated economies of scale. In concluding that the benefits accruing to WRIMCO and its affiliates by virtue of their relationship to the Fund were reasonable in comparison with the costs of providing the investment management services and the benefits accruing to the Fund, the Disinterested Directors considered specific data as to WRIMCO's profit or loss with respect to the Fund for a recent period. The Directors also considered WRIMCO's methodology for determining this data.

In determining whether to approve the proposed continuance of the Management Agreement, the Directors considered the best interests of the Fund and the overall fairness of the proposed Management Agreement. The Directors considered the following factors to be of primary importance to their approval of the continuance of the Fund's Management Agreement, without any one factor being dispositive:

- the performance of the Fund compared with the average performance of a peer group of comparable funds and with relevant indices;
- the Fund's investment management fees and total expenses compared with the management fees and total expenses of a peer group of comparable funds;
- the existence or appropriateness of breakpoints in the Fund's management fees;
- the cost/profitability to WRIMCO and any actual or anticipated economies of scale in relation to the services it provides to the Fund;
- the other benefits that accrue to WRIMCO as a result of its relationship to the Fund; and
- the favorable history, reputation, qualification and background of WRIMCO as well as the qualifications of its personnel.

Based on the discussions, considerations and information described generally above, the Board determined that the Fund's Management Agreement is fair and reasonable and that continuance of the Management Agreement was in the best interests of the Fund. In reaching these determinations, the Board concluded that: the nature, extent and quality of the services provided by WRIMCO for the Fund are adequate and appropriate; the performance of the Fund was satisfactory; it retained confidence in WRIMCO's overall ability to manage the Fund; and the management fee paid to WRIMCO was reasonable in light of comparative management fee information, the breakpoints in the proposed management fee for the Fund, the services provided by WRIMCO, the costs of the services provided, and the profits realized and other benefits likely to be derived by WRIMCO from its relationship with the Fund.

Annual Privacy Notice

Waddell & Reed, Inc., Waddell & Reed Advisors Group of Mutual Funds and Waddell & Reed InvestEd Portfolios, Inc. (Waddell & Reed) are committed to ensuring their customers have access to a broad range of products and services to help them achieve their personal financial goals. In the course of doing business with Waddell & Reed, customers are requested to share financial information and they may be asked to provide other personal details. Customers can be assured that Waddell & Reed is diligent in its efforts to keep such information confidential.

Recognition of a Customer's Expectation of Privacy

At Waddell & Reed, we believe the confidentiality and protection of customer information is one of our fundamental responsibilities. And while information is critical to providing quality service, we recognize that one of our most important assets is our customers' trust. Thus, the safekeeping of customer information is a priority for Waddell & Reed.

Information Collected

In order to tailor available financial products to your specific needs, Waddell & Reed may request that you complete a variety of forms that require nonpublic personal information about your financial history and other personal details, including but not limited to, your name, address, social security number, assets, income and investments. Waddell & Reed may also gather information about your transactions with us, our affiliates and others.

Categories of Information that may be Disclosed

While Waddell & Reed may disclose information it collects from applications and other forms, as described above, we at Waddell & Reed also want to assure all of our customers that whenever information is used, it is done with discretion. The safeguarding of customer information is an issue we take seriously.

Categories of Parties to whom we disclose nonpublic personal information

Waddell & Reed may disclose nonpublic personal information about you to the following types of third parties: selectively chosen financial service providers, whom we believe have valuable products or services that could benefit you. Whenever we do this, we carefully review the company and the product or service to make sure that it provides value to our customers. We share the minimum amount of information necessary for that company to offer its product or service. We may also share information with unaffiliated companies that assist us in providing our products and services to our customers; in the normal course of our business (for example, with consumer reporting agencies and government agencies); when legally required or permitted in connection with fraud investigations and litigation; and at the request or with the permission of a customer.

Opt Out Right

If you prefer that we not disclose nonpublic personal information about you to nonaffiliated third parties, you may opt out of those disclosures, that is, you may direct us not to make those disclosures (other than disclosures permitted by law). If you wish to opt out of disclosures to nonaffiliated third parties, please provide a written request to opt out with your name and account number(s) or social security number to: Waddell & Reed, Attn: Opt Out Notices, P.O. Box 29220, Shawnee Mission, Kansas 66201. You may also call 1-888-Waddell and a Client Services Representative will assist you.

Confidentiality and Security

We restrict access to nonpublic personal information about you to those employees who need to know that information to provide products and services to you. We maintain physical, electronic, and procedural safeguards that comply with federal standards to guard your nonpublic personal information. If you decide to close your account(s) or become an inactive customer, we will adhere to the privacy policies and practices as described in this notice.

Proxy Voting Information

Proxy Voting Guidelines

A description of the policies and procedures Waddell & Reed Advisors Group of Mutual Funds uses to determine how to vote proxies relating to portfolio securities is available (i) without charge, upon request, by calling 1.888.WADDELL and (ii) on the Securities and Exchange Commission's (SEC) website at www.sec.gov.

Proxy Voting Records

Information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available on Form N-PX through Waddell & Reed's website at www.waddell.com and on the SEC's website at www.sec.gov.

Quarterly Portfolio Schedule Information

A complete schedule of portfolio holdings for the first and third quarters of each fiscal year will be filed with the Securities and Exchange Commission (SEC) on the Fund's Form N-Q. This form may be obtained in the following ways:

- On the SEC's website at www.sec.gov.
- For review and copy at the SEC's Public Reference Room in Washington, DC. Information on the operations of the Public Reference Room may be obtained by calling 1.800.SEC.0330.
- On Waddell & Reed's website at www.waddell.com.

Householding Notice

If you currently receive one copy of the shareholder reports and prospectus for your household (even if more than one person in your household owns shares of the Fund) and you would prefer to receive separate shareholder reports and prospectuses for each account holder living at your address, you can do either of the following:

Fax your request to 800.532.2749.

Write to us at the address listed on the back cover.

Please list each account for which you would like to receive separate shareholder reports and prospectus mailings. We will resume sending separate documents within 30 days of receiving your request.

The Waddell & Reed Advisors Funds Family

Global/International Funds

Waddell & Reed Advisors Global Bond Fund

Waddell & Reed Advisors International Growth Fund

Domestic Equity Funds

Waddell & Reed Advisors Accumulative Fund

Waddell & Reed Advisors Core Investment Fund

Waddell & Reed Advisors Dividend Income Fund

Waddell & Reed Advisors New Concepts Fund

Waddell & Reed Advisors Small Cap Fund

Waddell & Reed Advisors Tax-Managed Equity Fund

Waddell & Reed Advisors Value Fund

Waddell & Reed Advisors Vanguard Fund

Fixed Income Funds

Waddell & Reed Advisors Bond Fund

Waddell & Reed Advisors Government Securities Fund

Waddell & Reed Advisors High Income Fund

Waddell & Reed Advisors Limited-Term Bond Fund

Waddell & Reed Advisors Municipal Bond Fund

Waddell & Reed Advisors Municipal High Income Fund

Money Market Funds

Waddell & Reed Advisors Cash Management

Specialty Funds

Waddell & Reed Advisors Asset Strategy Fund

Waddell & Reed Advisors Continental Income Fund

Waddell & Reed Advisors Retirement Shares

Waddell & Reed Advisors Science and Technology Fund

1.888.WADDELL

Visit us online at www.waddell.com

Investors should consider the investment objectives, risks, charges and expenses of a fund carefully before investing. For a prospectus containing this and other information for the Waddell & Reed Advisors Funds, call your financial advisor or visit us online at www.waddell.com. Please read the prospectus carefully before investing.

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